

## HR Law Hotline

February 19, 2013

### EMPLOYEE STOCK OPTION PLANS IN INDIA: RESTRICTIONS ON TRUST STRUCTURES

The Indian securities market regulator has prohibited listed companies in India from framing any employee benefit scheme involving acquisition of the company's own securities from the secondary market. The Securities and Exchange Board of India ("SEBI") issued a circular on January 17, 2013<sup>1</sup> ("Circular") to amend the SEBI (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999 ("ESOP Guidelines") and the Equity Listing Agreement.

#### BACKGROUND

SEBI issued the ESOP Guidelines in 1999 to regulate the implementation of stock option schemes and stock purchase schemes by Indian listed companies. In the past, SEBI had taken a view that employee welfare schemes that did not involve fresh issuance of securities of the company would not fall within the scope and ambit of the ESOP Guidelines.<sup>2</sup> Accordingly, schemes that involved purchase of securities from the secondary market by a trust or otherwise like stock appreciation schemes were unregulated. In its board meeting in August 2012<sup>3</sup>, SEBI, inter alia, decided that "Listed entities shall frame employee benefit schemes only in accordance with SEBI (ESOS and ESPS) Guidelines, 1999. Entities whose schemes are not in conformity with the same would be given time to align with the said Guidelines. Further, such schemes will be restrained from acquiring their shares from the secondary market." It appears that such a decision was taken after SEBI undertook a comprehensive review of the extant regulatory framework in the primary market and approved a host of reforms to re-vitalise the markets. The decision to amend the ESOP Guidelines, among other changes, was made with a view to "ensure quality public offerings, instill discipline amongst issuers/market intermediaries, make the issue process more transparent, provide a level playing field for all market participants and enhance investor confidence"<sup>4</sup>.

SEBI has expressed its apprehensions over the possibility of listed companies framing staff welfare schemes/trusts to deal in their own securities in the secondary market, with the object of inflating, depressing, maintaining or causing fluctuation in the price of the securities and engaging in market manipulation and other fraudulent trade practices. According to SEBI, such practices also raise significant compliance concerns under the SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to the Securities Market) Regulations, 2003 and SEBI (Prohibition of Insider Trading) Regulations, 1992.

#### KEY AMENDMENTS

In order to address the concerns pertaining to acquisition of shares by employee welfare trusts of listed companies from the secondary market, SEBI has, vide the Circular, introduced the following amendments to the ESOP Guidelines and the Equity Listing Agreement:

- Amendment of the ESOP Guidelines to prohibit acquisition of securities from the secondary market:** New clause 22B has been included in the ESOP Guidelines stipulating that employee stock option scheme or stock purchase scheme shall not involve acquisition of own securities from the secondary market.
- Amendment of the Equity Listing Agreement:**  
Clause 35C has been included in the Equity Listing Agreement to require:  
The issuer to ensure compliance with the revised SEBI Guidelines with respect to all new employee benefit schemes involving the securities of the company; and The issuer shall also ensure that all existing employee benefit schemes, i.e., schemes framed and implemented by the company involving dealing in the securities of the company in the secondary market, before 17 January, 2013 are aligned with and made to conform to the revised SEBI Guidelines by 30 June 2013.
- Disclosure requirements:** Companies which have existing employee benefit schemes that do not conform to the ESOP Guidelines (as amended by the Circular) are now required to inform the details of their schemes to the stock exchanges, in the prescribed format, within 30 days of the date of issue of the Circular, i.e., February 16, 2013 and disseminate the prescribed information on their website. Some key disclosures to be made include, (i) name of the scheme; (ii) date of implementation; (iii) mode of implementation (trust route or direct route); (iv) details of the trust, trustees, and their relationship with promoters or directors of the company; (v) whether promoters/persons belonging to the promoter group/directors are also beneficiaries in the scheme and details of their entitlements; (vi) number of shares held by the trust or any other agency managing the scheme as on the date of the Circular; (vii) details of how such trust/agency is proposing to deal with the existing holding (i.e., whether to be transferred to the employees, or to be sold in the market for transferring the benefits to the employees) and timelines for the same; (viii) details of persons who are entitled to shares or benefits accruing out

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of the shares, which, on the date of the Circular, form part of more than 1% of the paid up share capital of the company; and (ix) details of secondary market transactions by the company or trust or such other agency managing the scheme (if any) since April 2012 in the prescribed format.

ANALYSIS

The amendment appears to be for the benefit of the investors, especially since it stems from rising concerns pertaining to insider trading and unfair trade practices. At the same time, the Circular is likely to have a significant impact on the companies that have put in place employee benefit schemes involving purchase of shares from the secondary market as against issue of new shares by the company. While the ESOP Guidelines permit the use of trust structures for administering employee stock option plans, the Companies Act, 1956 permits a company to grant loans or financial assistance to employee welfare trust to purchase or subscribe to the shares of the company. In light of these provisions, many Indian companies had adopted employee welfare schemes where trusts purchased the securities of the company from the secondary market using the funds provided by the company. Such schemes of listed companies may now have to be restructured to align them with the requirements under the ESOP Guidelines.

We understand that the Associated Chambers of Commerce and Industry of India (ASSOCHAM) has sought an extension of deadline set for companies to comply with the amended rules<sup>5</sup>.

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<sup>1</sup> CIR/CFD/DIL/3/2013, [http://www.sebi.gov.in/cms/sebi\\_data/attachdocs/1358405632526.pdf](http://www.sebi.gov.in/cms/sebi_data/attachdocs/1358405632526.pdf)  
<sup>2</sup> Informal guidance CFD/DCR/SKM/TO/18378/2010 dated September 2, 2010 issued to Ramkrishna Forgings Limited; Informal Guidance CFD/DIL/IG/SK/VT/180/2010 dated April 5, 2010 issued to Siemens Ltd.  
<sup>3</sup> Minutes of SEBI Board Meeting, PR No. 77/2012: <http://www.sebi.gov.in/sebiweb/home/detail/24234/yes/PR-SEBI-Board-Meeting>  
<sup>4</sup> Minutes of the SEBI Board Meeting, PR No. 77/2012  
<sup>5</sup> <http://www.assocham.org/prels/shownews.php?id=3894>

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